Testimony of Kim Stubna, Director of Public Policy, First Data Corporation
Before the House Small Business Committee
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Good morning, Madam Chairwoman and members of the Committee. My name is Kim Stubna, and I am Director of Public Policy at First Data Corporation. I am pleased to be here today on behalf of First Data, and I appreciate the opportunity to share with you our concerns with the Administration's and Senate Finance Committee's proposals to require annual reporting to the IRS of merchants' electronic transactions. After providing a brief overview of First Data's role in the payments sector, I will focus my comments on three primary areas of concern with the proposals: (1) the negative economic impact to our nation's small businesses; (2) the difficulty of linking the required data; and (3) the inevitable reporting of inaccurate merchant payment transaction data to the IRS. While the proposals would unequivocally subject First Data and others within the payments sector to considerable new operational challenges and costs along with significant administrative and compliance costs, we believe that America's small businesses – the backbone of our nation's economy – will suffer considerably if this proposal is enacted into law.

First Data is a Denver-based technology services company that is the leading processor of electronic payment transactions. We rank in the top 320 on the Fortune 500 list and employ over 27,000 employees globally. Our services help consumers, businesses and governmental entities make payments for goods and services using virtually any form of payment – credit card, debit and stored value card, electronic checks and paper checks – at the point of sale and over the Internet. Additionally, we own and operate the STAR debit network, one of the leading nationwide electronic funds transfer (EFT) networks, as well as the Instant Cash ATM network.

Under the Visa/MasterCard Association rules, in order for a merchant (e.g. online retailer, convenience store, restaurant, or grocery store) to be able to accept Visa or MasterCard credit cards as a form of payment, a member bank must "sponsor" that merchant into the system – and thus becomes the acquiring bank. Any one of the 2,000 banks in the United States that is a member of the card associations must be a party to the merchant processing contract. For the actual processing services, however, many bank members outsource to third parties such as First Data.

Under these processing arrangements, First Data authorizes, captures and settles merchants' credit, debit, stored value and loyalty card transactions, and we do this for over 4 million merchant locations in the U.S. Stated more simply, the services we provide with our bank partners enable you to approach a check-out counter (whether it be bricks and mortar or through the Internet) and pay for your goods or services with a credit, debit or stored value card such as a gift card.

In short, the proposals on which we're commenting today would require merchant acquirers to annually report to the IRS through a form 1099 the aggregate value of electronic transactions received by every merchant. (First Data has provided comments to both the Administration and the Senate Finance Committee staff on their versions of the proposal.) First Data partners with merchant acquiring banks to process the largest number of transactions in the United States, so it is clear that we, along with our nation's small businesses, would shoulder the impact of this ill-conceived proposed regulatory burden.

There are several components of the proposals to which we're opposed, but one of the most harmful provisions to small businesses would require us to subject merchants to backup withholding. This provision would require us to withhold 28 percent of a small business' cash flow until the accuracy of their Taxpayer Identification Number (TIN) was verified. Withholding 28 percent of a small business' cash flow could very well mean the difference between making payroll and laying off employees or worse. Such government mandated actions, particularly during an economic slowdown, could serve to exacerbate our current economic struggle. We feel strongly that the potential for inaccurately withholding payments to merchants also places merchant acquirers in a liability position that would be extremely difficult to correct. The damage to a merchant of not being able to make payroll or keep the lights on has long lasting irrevocable effects. In turn, payment processors would be exposed to significantly new litigation risk directly attributable to the IRS proposal. In addition, it is clear to us that the potential for withholding payments to merchants that fail to submit or inaccurately complete a

Form W-9 would place acquirers and processors in an adversarial position with their merchant customers.

The issue of correctly matching the merchant TIN information leads to our second point, which is the difficulty of linking merchant payment transaction data to the TIN. Our merchant processing business may collect a merchant's SSN (Social Security Number) or TIN during an initial application process, but then each merchant is assigned a unique identification number. At this point, merchants are identified solely by their unique ID numbers which, in various scenarios, do not correspond with the TIN that would have to be utilized for reporting the processed sales to the IRS. Even if our payment systems were developed with a structure that assigned merchant IDs in a fashion consistent with TIN assignment, compiling composite data is much more complex and challenging than simply matching transactions associated with one merchant ID to one applicable SSN or TIN. In some circumstances, more than one merchant ID (same merchant/multiple locations) would need to be linked to the same TIN. In short, our systems do not currently track merchant payment transaction data to TINs and it will be extremely expensive and time consuming to reprogram our systems to comply with the new mandates.

Another complex scenario occurs with a merchant that has multiple franchise members that are separate legal entities with individual TINs or SSNs. In this case, First Data will establish a merchant ID family for that franchise that may begin with a corporate owner with a specific TIN, but each franchise member has its own TIN or SSN, and First Data assigns individual merchant IDs within that family.

As a result, First Data's numerous and intricate payment processing systems would likely have to be entirely reprogrammed with complex logic designed to find the correct information links to accommodate the various scenarios that could arise. Conservative estimates place this programming at over 3,000 man hours for *each* of our processing systems, and First Data has between 4 and 10 processing platforms depending on the defined payment types included. Additional expenses would be incurred from maintenance, management and servicing needs. First Data cannot absorb this enormous expense on its own, so these costs would likely be passed on to merchants. Consequently, it would not be implausible for this proposal to discourage some merchants from accepting electronic payments and steering customers toward cash and checks – making it that much more difficult for the IRS to achieve its main objective to identify entities that under-report their taxable income.

Finally, the proposals would result in the reporting of inaccurate merchant payment transaction data to the IRS for a portion of merchants. This fact is a critical issue that cannot be minimized or overlooked. From a processing standpoint, determining the revenue of a merchant transaction is not as simple as looking at the final sale on a receipt. For example, a typical merchant transaction in our system may include a sale minus returns, plus/minus charge backs, plus/minus reversals, plus/minus arbitration charge backs, plus/minus compliance filings, to name a few. Additionally, discount fees, interchange and other processing fees must be accounted for when assessing the sales revenue of an individual merchant. To further complicate matters, PIN (Personal Identification Number) debit cash back transactions are not separated in our systems. For example, in a PIN debit cash back scenario a consumer uses their debit card and their PIN to purchase $60 worth of goods and decides to get $40 in cash at the same time. With these types of transactions, First Data's payment systems see that the merchant needs to be paid $100 by the consumer's bank. As a result, we would be required to report to the IRS that the merchant received $100 in sales revenue, when in fact they only received $60 in sales revenue. This would be unfair to the merchant since it is clearly erroneous information biased against that particular merchant.

Another likely example of reporting inaccurate data would occur when the transaction lifecycle (from original sale to last chargeback cycle) exceeds one year and/or carries over from one year to the next. For instance, a cardholder orders a custom computer and pays at the time of the order. The order is expected to be delivered in three months, but after four months, the cardholder hasn't received the computer and initiates a chargeback for goods not received. At this point, the merchant would be at $0 net payment. However, the merchant provides shipping proof and authentication at the time of the sale, the cardholder receives the computer and a chargeback reversal occurs. The merchant is now net for the transaction amount. Once the cardholder starts using the computer, it doesn't operate as requested, so the cardholder initiates another chargeback as “item not as described,” and the cycle begins again. Processing and interchange fees must also be factored into the equation, as they affect the transaction amounts as well. It is not uncommon for these processes to occur over two tax years.

While First Data stands firmly opposed to the merchant card reporting proposals, we do believe that a legitimate alternative exists: to create a new section on the current merchant tax filing form that requires the merchant to self report its total annual amount of credit and debit card and open loop card stored value card transactions (e.g. stored value cards issued by a financial institution). Based on past discussions we have had with the IRS, it appears this has some precedence, as they remarked that the number of taxpayers claiming dependents decreased when taxpayers were required to report a dependent’s SSN on the form. Extending this same rationale to our alternative, the number of merchants accurately reporting their electronic transactions should increase at some level, and it would impose significantly fewer operational costs and administrative burdens on the payments industry. Furthermore, a study could be mandated in conjunction with the self reporting requirement to assess its effectiveness in increasing compliance.

If, on the other hand, the proposals move forward in their current constructs, there is little concrete evidence that the benefits that the IRS expects to realize outweigh the enormous costs that would be imposed on the payments industry and our nation’s small businesses. Instead, the proposals are predicated on the IRS’ belief that many merchants, particularly smaller ones, are under-reporting their income, and that third party reporting could result in a material increase in compliance in reported taxable income by businesses.

The reality is that due to the complexity of the payments system that was designed to safely and quickly move money rather than become an extension of the IRS, the proposal would lead to: (1) the distinct possibility that some merchants, subject to a withholding penalty, may go out of business; (2) the expenditure of significant financial and operational resources; (3) the reporting of inaccurate merchant payment transaction data; (4) an increase in the cost of accepting electronic payments, harming both consumers and merchants; and (5) a shift by payment processors to re-direct data processing and compliance specialists away from innovative, revenue generating products, reducing our competitiveness.

We urge the Committee to convey its concerns with and opposition to these proposals to both the Administration and to congressional leaders in both parties and in both chambers. The issues that we have outlined should not be underestimated because the ramifications would be detrimental to the payments industry, to small businesses that drive the nation's growth, and to consumers who would likely see an increase in the cost of goods and services – directly attributable to the costs of implementing these proposals.